

NOV 20 1967

JOHN F. BROWN, CLERK

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1967

No. 760

COMMISSIONER OF INTERNAL REVENUE, *Petitioner*

v.

IRVING GORDON and MARGARET GORDON, *Respondents*

On Petition for a Writ of Certiorari to the
United States Court of Appeals
for the Second Circuit

MEMORANDUM FOR RESPONDENTS

HARRY R. HORROW,
STEPHEN J. MARTIN,
Standard Oil Building,
225 Bush Street,
San Francisco, California 94104,
Attorneys for Respondents.

PILLSBURY, MADISON & SUTRO,
Standard Oil Building,
225 Bush Street,
San Francisco, California 94104,
Of Counsel.

In the Supreme Court.

OF THE
United States

OCTOBER TERM, 1967

No. 760

COMMISSIONER OF INTERNAL REVENUE, *Petitioner*

v.

IRVING GORDON and MARGARET GORDON, *Respondents*

On Petition for a Writ of Certiorari to the
United States Court of Appeals
for the Second Circuit

MEMORANDUM FOR RESPONDENTS

Respondents ("taxpayers"), agree with the statement of facts in the petition. However, in setting forth the questions presented (Pet., p. 2), petitioner has implied that the 1961 issuance of the Northwest rights by Pacific to its shareholders was a transaction separate from the issuance of the Northwest rights by Pacific to its shareholders in 1963. The Tax Court expressly found as a fact, not challenged by petitioner on review before the court below, that the two offerings of the Northwest stock were component parts of a single plan and that they must

be regarded together as resulting in the disposition of 100 per cent of the Northwest stock in a single transaction (45 T.C. 71, 87). The question properly stated then is whether, under section 355 of the Internal Revenue Code of 1954, taxpayers received their stock in Northwest as part of a non-taxable spinoff distribution by Pacific of all of the stock of Northwest, a controlled corporation, as held by the Tax Court, and the court below.

The second question presented here is whether the court below properly ruled that the proceeds of sale of the rights were taxable as long-term capital gains, rather than dividend income, as held by the Tax Court.

The instant case and the *Baan* case (Oct. Term, 1967, No. 781) were two test cases instituted in the Tax Court to challenge the validity of ruling letters issued by the Commissioner of Internal Revenue that the receipt of the Northwest stock by noncorporate shareholders of Pacific, through the exercise of rights under the plan of reorganization referred to, gave rise to dividend income equal to the difference between the amount paid in exercise of the rights and the value of the Northwest stock at the date of exercise. In addition, in the *Gordon* case, the taxpayers challenged the ruling of the Commissioner that the sale of such rights gave rise to ordinary income rather than capital gain.

There were approximately 25,000 noncorporate shareholders of Pacific adversely affected by these rulings. The two cases were tried on identical records and consolidated for trial and opinion in the Tax Court, which held that no taxable income resulted under section 355 from the exercise of rights to acquire Northwest stock. Over 95

per cent of the shareholders in Pacific before 1961 exercised their rights and became shareholders in Northwest (Pet., p. 22). If all of the Northwest stock had been distributed by Pacific to its shareholders without the payment of cash by them, the transaction would clearly have qualified as a classic divisive tax-free reorganization under section 355. The Tax Court found it inconceivable that Congress could have intended that under section 355 the receipt of Northwest stock by the Pacific shareholders would be taxable, where the shareholders were required to contribute to the capital of Pacific as a condition to receiving the Northwest stock. The Tax Court also ruled contrary to the Commissioner on the tax treatment of the sale of rights, holding that the proceeds of the sale of the rights were taxable as dividend income. The Second Circuit Court of Appeals decided both issues in favor of the taxpayers, Judge Friendly dissenting. The decision of the Second Circuit Court of Appeals was handed down on July 26, 1967, after the Ninth Circuit Court of Appeals had decided the *Baan* case in favor of the Commissioner, reversing the Tax Court. The decision of the Second Circuit Court of Appeals, therefore, is in direct conflict with the decision of the Ninth Circuit Court of Appeals in the *Baan* case.

Section 355 is a comprehensive statutory provision designed to deal in one section with so-called divisive corporate reorganizations whether they take the form of split-offs, split-ups or spinoffs. This section involves corporate reorganizations of considerable magnitude, and the questions involved, on which the Ninth Circuit and Second Circuit are in disagreement, are novel and continuing. In

addition, the tax treatment of the sale of rights involves important questions in the application of the landmark decision in *Palmer v. Commissioner* (1937) 302 U.S. 63. These questions on the tax treatment of the sale of rights are interrelated with the tax problems involved as to whether the exercise of the rights and the receipt of the Northwest stock were pursuant to a tax-free spinoff under section 355.

For these reasons, and the reasons stated at greater length in the petition for certiorari filed in the *Baan* case, *supra*, respondents concur in the conclusion that a petition for a writ of certiorari should be granted in this case.

Respectfully submitted,

HARRY R. HORROW,

STEPHEN J. MARTIN,

Attorneys for Respondents.

PILLSBURY, MADISON & SUTRO,

Of Counsel.

November 1967.